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SUBJECT: AUDI ON EU CO2 RULES, THE FUTURE OF THE AUTOMOBILE, AND THE
U.S. MARKET

SENSITIVE BUT UNCLASSIFIED. NOT FOR INTERNET DISTRIBUTION.

REF: (A) MUNICH 100; (B) BERLIN 560

SUMMARY

¶1. (SBU) Senior Audi officials told ConGen Munich they share BMW's view that proposed EU CO2 rules represent nothing less than French industrial policy. Going a step further, they made the questionable argument that the EU rules would effectively "kill" the European auto industry while achieving little benefit to the environment. The Audi officials added that the European subsidiaries of U.S. firms Ford and GM were, in Audi's view, part of the problem, as they appeared to have sided with the French and Italian manufacturers of smaller cars, rather than with the German premium manufacturers. Unlike BMW, Audi stopped-short of praising the Merkel government's efforts on behalf of the German auto industry. Like BMW, Audi has an aggressive research program to build cleaner cars for the future, although leaving more advanced technologies, such as hydrogen, off the table for now. Despite the impact of the weak dollar, Audi appeared largely unenthusiastic about possibly opening a U.S. production facility. End Summary.

AUDI: EU RULES WOULD "KILL" EUROPE'S AUTO INDUSTRY

¶2. (SBU) In a follow-on to an earlier meeting with BMW on EU CO2 regulations (Ref A), ConGen Munich met with Audi officials at the firm's Ingolstadt headquarters, including Senior V.P. for the American Region Matthias Braun, Head of Government Relations Brigitte Manitz, Product Manager for American Region Peter Kremer, and Volkswagen Group's Manager for Research and Development/Authorities and Regulations Dr. Klaus-Peter-Schindler. Like their BMW counterparts, the Audi officials were skeptical of proposed EU CO2 rules limiting auto producers' CO2 emissions to 120g/km based on a fleet-wide average by 2012. The Audi officials not only shared BMW's view that the EU rules represented French industrial policy, but going a step further, argued that the proposal would effectively "kill" not only the German automotive industry, but the European auto industry as a whole, while achieving relatively little in the way of cleaner air.

¶3. (U) When asked about the dire prediction of the demise of the European auto industry, Manitz explained that it would be nearly impossible for the German premium segment to survive under the EU rules. According to Manitz, without the premium segment the German auto industry would find it difficult to compete only in the low-end market, given the significant cost advantages enjoyed by Asian and

Eastern European manufacturers of small cars. Additionally, Germany's smaller, less expensive cars benefit from the technological developments that "trickle-down" after being initially engineered into its expensive premium models. Manitz argued that the extensive R&D that goes into expensive models can't be justified for cheaper cars -- a loss which will not only affect the German industry, but other European manufacturers that benefit from technology licensed from German firms, putting all European manufacturers at risk.

GOING AFTER LOW-VOLUME PRODUCERS ACHIEVES LITTLE

14. (U) Like BMW, our Audi interlocutors made it clear they were not opposed to environmental regulation, but wanted rules that safeguarded a level playing field among all car manufacturers. Manitz argued that the EU rules focus too much on the relatively small number of heavy premium cars sold in Europe, while effectively ignoring the much larger market share of smaller, lighter cars. To illustrate their case, the Audi officials explained that if the 50 car models with the highest CO2 emissions reduced CO2 emissions by 20 percent, the overall CO2 emissions from automobiles would drop by just 0.5 percent. However, a 20 percent CO2 reduction for the 50 highest-selling cars in Europe (mostly smaller, lighter cars) would reduce overall automotive CO2 emission by 14 percent. In other words, the current proposal would devastate Germany's relatively low-volume premium sector, but achieve little overall environmental impact. Manitz said Audi would also like the EU to take into account other factors in formulating CO2 rules, including efficiency of automotive systems such as air conditioning, and a phase-in period for the rules which takes the product development cycle into

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account.

U.S. MANUFACTURERS NOT HELPFUL; BERLIN COULD DO MORE

15. (SBU) Our interlocutors observed that the European subsidiaries of U.S. manufacturers Ford and General Motors appeared to be lining-up with French and Italian manufacturers of small cars like PSA (France) and Fiat (Italy). They referred to a case in which Ford and GM had intervened with the Belgian car manufacturer's association, preventing it from taking a position on CO2 emissions that would have been favorable to manufacturers of heavier cars. The Audi officials said this lack of unanimity among German car manufacturers on CO2 rules made lobbying more difficult [Note: Separate Mission Germany discussions with Ford and GM suggest whatever daylight exists between German manufacturers is minor, and that both U.S. manufacturers are firmly against the EU proposal. End Note]. Manitz added, however, that ultimately Audi was in a better position than BMW or Mercedes given that it was part of the Volkswagen Group, which offered a broader range of cars than its competitors, helping it to mitigate the impact of any new rules on the company. When asked if Audi believed the Merkel government in Berlin was doing enough to defend the interests of the German auto industry, Manitz obliquely answered by saying the French government does a very effective job of looking-out for French economic interests when formulating environmental and other policies.

AUDI FUTURE-TECH

16. (U) Asked how Audi viewed the future of the automobile given the increasing demand for clean technology, Schindler told us he expected gasoline would remain the predominant fuel until the middle of this century. He noted that Audi, like BMW, was committed to diesel technology, and was currently working on improving a "clean" diesel engine design originally developed by Mercedes. While diesels accounted for nearly half of sales in Germany, Audi was cautious about the prospects for diesel sales in the U.S. given the lingering negative image from earlier generations of diesels. As with BMW, Audi anticipates a menu of technologies will be used to

address the demand for less polluting transportation, rather than a single dominant propulsion source.

¶7. (U) Audi is particularly focused on developing better battery technology, given its application to both hybrid and fully electric vehicles. Schindler said Audi was not as bullish on hybrid technology as other manufacturers such as Toyota, arguing hybrids only make sense in relatively heavy stop-and-go traffic conditions where their efficiency comes into play. Breaking with its BMW brethren, Audi is notably unbullish on hydrogen fuel cell technology, arguing that, in addition to the cost of producing hydrogen fuel, fuel cells take up too much valuable space within the car. Furthermore, hydrogen fuel cells would be produced with expensive precious metals which manufacturers would have to import from sources such as Russia. Schindler also saw little promise in biofuels, particularly given the dramatic increases in food prices recently. Additionally, the energy required to produce and transport biofuels (ethanol can't be shipped via pipeline like gasoline, for example) gave them little or no CO2 advantage over traditional fossil fuels.

WILL AUDI JOIN BMW AND MERCEDES IN THE U.S?

¶8. (SBU) Although Audi has a goal of roughly doubling its sales in the U.S. to 200,000 units per year by 2015, Audi officials appeared unenthusiastic about setting-up production in the U.S, as BMW and Mercedes have done. While the current weak dollar might argue for a U.S. plant, Braun noted future exchange rates may be very different, perhaps making this strategy less attractive. Braun said U.S. production would make sense if Audi could sustain sales above 150,000 units per year. However, Audi would also want to have at least 80 percent local content allowing it to minimize the cost of shipping components across the Atlantic. Braun said one possibility for U.S. production would be if Audi parent Volkswagen were to set up a U.S. plant again, as it did in Pennsylvania from 1978 to 1988. Manitz said that another complicating factor was that BMW and Mercedes had experienced difficulties building a skilled labor force in their U.S. plants, given the lack of an apprenticeship system as Germany has. Braun explained that while the U.S. remains a very

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important market for Audi, other markets, notably China, offered greater opportunities for Audi's attention at the moment.

COMMENT

¶9. (SBU) Audi's views of the EU's proposed carbon-reduction rules closely mirror those of BMW, including plainly calling the rules French "industrial policy." Audi's views diverged from BMW's, however, in some notable areas. While BMW was relatively quick to express satisfaction with Berlin's efforts on behalf of the German auto industry, Audi was reluctant to do so. We also had not anticipated Audi's criticism of Ford and GM -- something we had not heard from BMW. Audi's argument that the European auto industry would be fatally strangled by the EU rules strikes us as simply overstated, and clearly intended to elicit opposition to Brussels' plan.

¶10. (U) This report has been coordinated with Embassy Berlin and Consulate General Duesseldorf.

¶11. (U) Previous reporting from Munich is available on our SIPRNET website at www.state.gov/p/eur/munich/ .

NELSON